DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 1759
La Jolla, Calif. 92037

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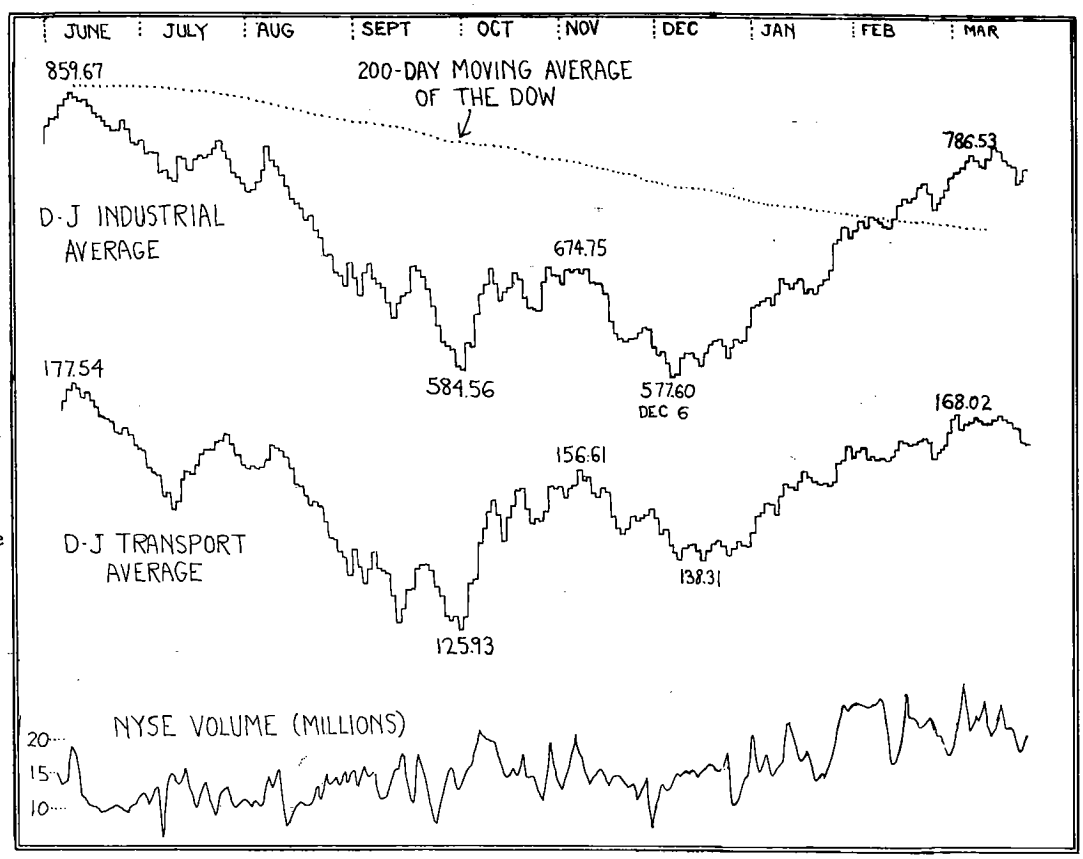
THE PICTURE: The great destroyer of stock market analysts is their own pride of opinion. Pride has ruined more so-called market experts than has any other single character defect. The public, in its innocence, all too frequently mistakes the analyst's pride for "intelligent confidence" or "steadfastness." So the public's losses are often linked to the analyst's defective prophecies.

People ask me, "Russell, how the hell do you know it's a bull market?" My answer is that I don't know anything when it comes to the stock market. I deal with probabilities, possibilities, and how things work now compared to how they worked in the past. I think we are in a primary bull market for a lot of reasons, but they're only my own reasons, my own research, my own findings, and my own intuitions. You want certainty? Read one of the cocksure services. I read them myself, and if they agree with me, why I'll admit that I feel better. But I know in my heart that the sure ones are either ignorant or fakers, and they are only selling what people want — a few drops of "certainty" in an uncertain world.

~~What's the difference between a primary bull market and a major upward correction in a bear market?~~ A ~~true bull~~ swing is fundamental, it possesses forecasting value, it moves in the direction of the major tidal force. A bear rally (no matter how great) is a technical phenomenon, it is a corrective movement, a bounce against the underlying tidal force. And of course, from the investor's standpoint, the difference between a bull swing and a bear rally is crucial. You can hold your stocks through a bull swing and even the inevitable correction that follows, knowing that in time the market (and most, if not all, of your shares) will climb to ultimate new highs. But hold your stocks through a bear rally and beyond, and you'll end up buying your wardrobe at Manny's Thrift Shop instead of Saks Fifth. It's as simple as that.

I have based my opinion regarding this market on the situation that prevailed in late-1974 and before. I have gone into the situation at great length in previous Letters, but in this mailing I have written a further piece with emphasis on the actual price structure (see "Was It a Bottom?" in later section).

Now let's get down to where we are and what's happening. As all my veteran subscribers know, primary bull markets have three psychological phases (not to be confused with price movements). The first phase is the return to "known values" following the depressed levels of the preceding bear market bottom. The second phase of a bull market is the rise in which the stock market reflects obviously improving conditions for business, improvements of all kinds — political, social, economic. The second phase is usually the longest and the most deceptive. The third and last psychological phase is the speculative phase. Here we see the entrance of the public in wholesale quantities, the euphoria, the spike movements in stocks, the tips, rumors, the standing-room-only in the boardrooms. The third phase is the very profitable and very dangerous one. It leads in time to the next bear market.



Where are we now? I feel that the first psychological phase of the bull market has drawn to a close. That the first phase could have developed so rapidly is unusual. But then, as I have said so often, I don't draw up the plans for the stock market, I just beat my brains out trying to figure what the stock market is telling me.

 We have seen a sensational rise that has taken the Dow from 577.60 in October to 786.53 on March 17, a rise of 36% in five months. During the same period many stocks moved up anywhere from 25% to 100% with a large number even doubling and tripling. To put it succinctly, the market as a whole has come back from the extreme undervaluation of late-1974 to a level of "known values."

The very rise itself tended to produce an air of mild optimism. By advancing over one-third from its low, the market (as measured by the Dow) is not telling us that all the US's problems are solved, far from it. But by signalling a bull trend, the market is telling us that the 1974 lows represented the worst stock levels we are going to see, regardless of how bad the business news becomes. In other words, October-December was Wall Street's way of protecting itself against the worst, the very worst.

Now the first psychological phase is over. Stocks have, in most cases, returned to known values, bounced back from the depressed lows of 1974. But just as shares pushed up all during December to March in the face of the numerous forecasts of disaster, I feel that we will now have a period of general sobering in the market. And while the great explosion in breadth (the A-D ratio) showed us that everything on the Board was undervalued in late-1974, I feel that from here on there is going to be more selectivity, more careful analysis of individual groups and companies, more divergence in group and stock action.

Usually (but not always) the three phases of a bull (or bear) market are separated by a correction. We are probably in such a correction now. How long will the current correction last? How deep will it be? The great majority of secondary corrections last a few weeks to a few months while tending to retrace one to two-thirds of the previously uncorrected primary advance. Since the Dow rise from December (577.60) to the March peak (786.53) was 209 points, a one-third correction would take the Dow back to about 716, a 50% correction would take the Dow to 681, and a two-thirds correction would take the senior Average back to 647.

News has a way of coinciding with bull market secondaries, and the March market slide was given a helping hand by the Mid-East talk breakdown and the assassination of King Faisal. I have stated before that the intensity of a correction is directly related to the primary correction that preceded. Considering the buying stampede of December to March, the downside "clean sweep" of March 24 and 25 was not unexpected. Nevertheless, it has been my observation that the worst market declines start with a slow dribbling action, rather than a shot from the blue. The rapid downside action of the past few days is typical of a bull market correction wherein the upside progress of months may be halved in a few days (it took three months for the Dow to rise 209 points from the December low, but in 6 trading days of March the Dow lost 21% of its total advance).

During the first phase, everything that wasn't nailed down was heading towards the rafters. That kind of stampede action may not be seen again or at least for a while. The lonely bulls of late-1974 had a picnic. Now the first phase is over, and the bears are having their try. As in physics, every action in the market produces its own reaction. These corrective reactions on Wall Street constitute the safety valves in the market boiler. Without them we would have explosions and explosions can bring utter destruction. Wise men prefer the safety of a correction.

Suppose some of the optimistic economists (such as S. Jay Levy) are right, I am asked. Suppose the economy turns up soon, in the face of all the towering Government deficits. Suppose the need for money by business starts ballooning, then what? We would then have improving business, which is bullish for stocks, plus a tightening money market, which is bearish for stocks. It's all a real possibility, and frankly, I don't have the answer to it, but that's why I study the market. Wall Street itself will come up with the answer. If it can't, it will back off and protect itself until the answer finally presents itself.

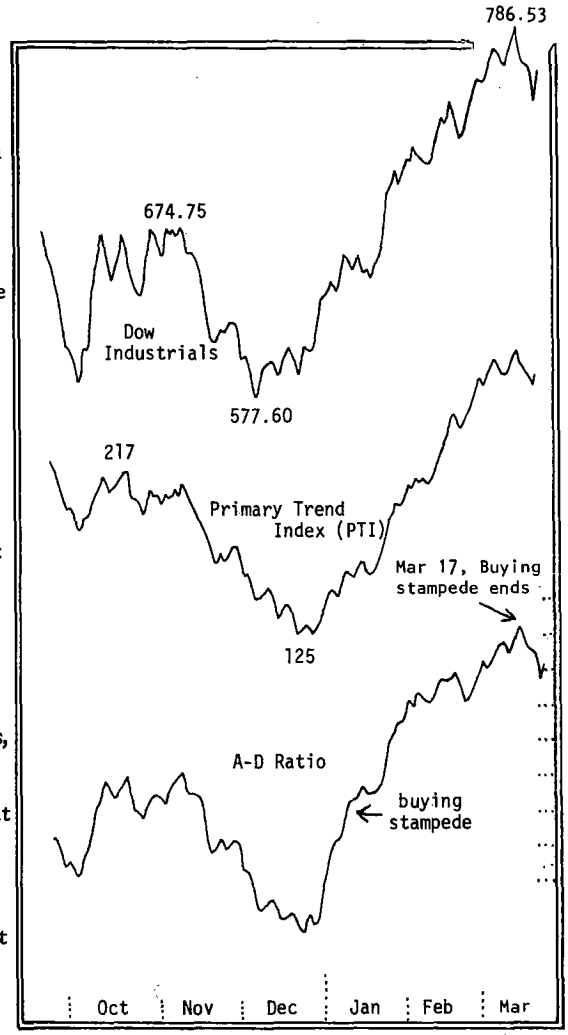
NEAR-TERM: On March 4 the D-J Transport Average struck a high of 168.02. A mild decline ensued, following which Industrials rallied to a new 1975 high of 786.58 (March 17). The new high was unconfirmed by Transports. I ended my last report with the warning, "Let's see if the Transports can get above the 168.02 high. If not, we could be moving into technical problems." Well, Transports could not get over 168.02, and we got the problems.

Interestingly, the A-D ratio hit a peak (Mar. 17) simultaneously with Industrials (see chart, page 3). Consequently, we did not see any of the non-confirmations between the A-D ratio and Industrials that have prefaced the great majority of major secondary reactions and bear markets. Of course, it is still possible that Industrials could rally to new 1975 highs unconfirmed by the A-D ratio, in which case the odds would increase considerably regarding a major and perhaps drastic decline. There have been a few cases in the past in which the Dow and the A-D ratio have topped together and plunged into a major decline, but these instances are the exception rather than the rule.

One thing is clear, however. The great buying stampede which began on December 23 ended on March 17. It lasted 60 trading days and advanced the A-D ratio 8.80 points. By Monday, March 24, the A-D ratio had dropped over 1 full point from its March 17 high, the first over-1-point drop in the A-D in 1975. That spelled the finish for the stampede. Whether we will see a resumption of this kind of stampede buying in 1975 remains to be seen. Personally, I would not be surprised to see a second and even a third buying stampede before this year is out.

As seen on the page 3 chart, the Primary Trend Index (PTI) has been rather resistant to the decline, and so far it is only 22 points below its high of the year, that high being 186 recorded (along with Industrials and the A-D ratio) on March 17. Resistance to the downside on the part of the PTI is a hopeful market sign. I might also add that increased selling (during a decline) on the part of the odd-lotter is a hopeful sign. Odd-lotters have definitely boosted their ratio of selling to buying on the decline from the March 17 peak.

I feel that time is going to be a factor in the current market decline. The market moved up very far and very fast during December to March, and the rate of ascent could not be sustained. The Momentum chart (see last Letter) implied that the market must



correct or at best "tread water" for a while. Technically, it is important to get the 13-week momentum line down towards 100 (it was 126 this week).

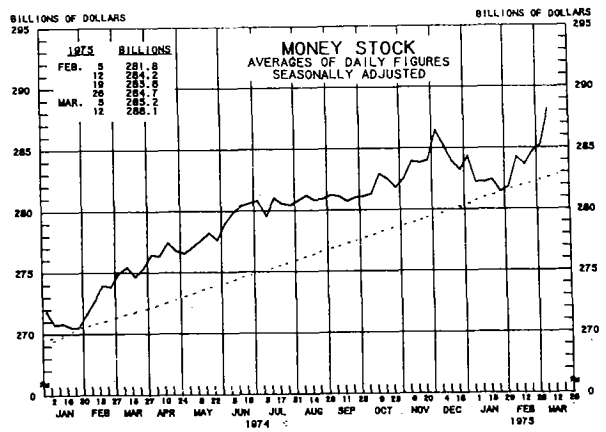
Secondly, the kind of heavy volume seen during January to March cannot be sustained. It would be healthy now to have a period of decline or consolidation, on contracting volume. It is also important to eliminate some of the speculative atmosphere that crept into Wall Street during February and early March. Contracting volume would be the happiest omen for the bulls in this area.

So far, the 25 million NYSE shorts have failed to get the great collapse they have been waiting for (note the new record high for shorts in March). Time itself works against the short seller, since they must pay out dividends and since they are tying up money in their short speculations. If the shorts cannot get some real encouragement during the next month, I feel that they will be staring disaster in the face. What destroys the short seller? It's a market that provides them with continual sharp, encouraging drops ("The market's going to zero") — but all within the context of a major and sustained primary (bull) sweep.

Note on the page 1 chart that the 200-day moving average of the Dow is down at about the 697 level. It is beginning to flatten after its long descent. The MA represents the long term sweep of the Dow. The 200-day MA will contain the Dow during most bull market corrections. As long as the Dow holds above its MA, I feel that the relationship of these two indicators is saying that the technical condition of the market is strong. In that case, the pressure will continue to be on the bears, and particularly on the record number of cash-on-the-line bears, the short sellers.

NOTES: Everyone tries to out-guess the market; everyone "knows" something that poor Wall Street doesn't. Three items deserve special mention at this time. About 90% of the investment advisors in the nation have noted the Feb. 21 top (81.96) in the D-J Utility Average. Therefore, they "reason," the market is finished. My comment, when everyone is concentrating on one indicator, forget it. Besides, Utilities are entitled to correct after their 44% rise from the 1974 lows.

Second, people walk up to me on the street and tell me that the money supply isn't growing. My answer is that too many Americans have suddenly become money experts. For this reason, I think that the Averages have now taken on the function of discounting the money supply figures (the market is now leading the lead money market indicators). My figures from the St. Louis Fed (which just arrived) show the money stock at a new high (so that could end the argument on the money supply).

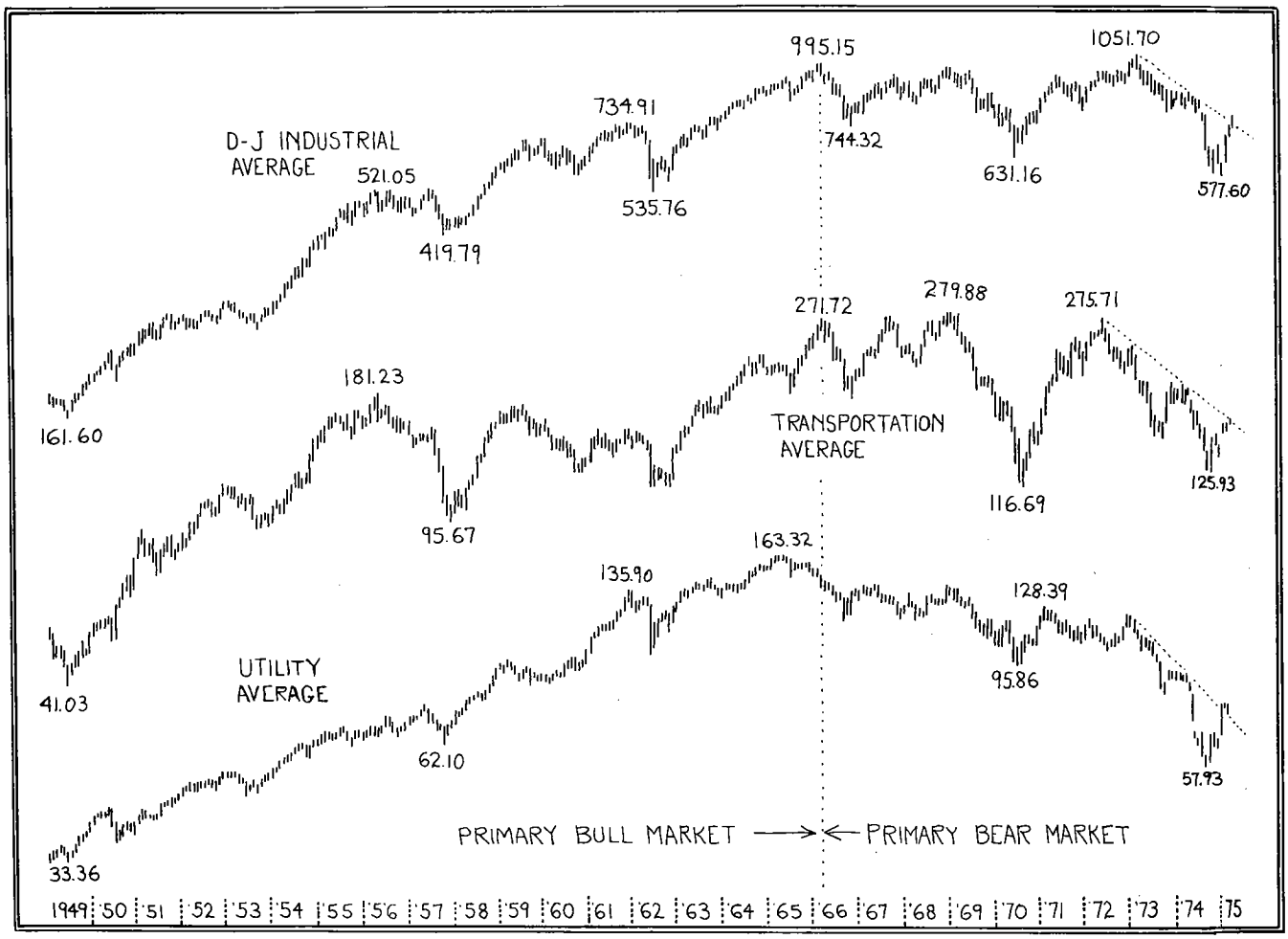


Final item: Suddenly, all the world knows this is 1930 all over again. So help me, two columnists in the latest issue of Forbes draw attention to the 1930 bear rally, as does a prominent citizen in the March 24 Barron's (Letters to the Editor). This may be 1930, but if it is, the advertising and advance billings have been terrific. It's remarkable, the number of people who want this damn bull market to collapse (to prove them right). I think they're going to be very frustrated. The public is well aware of the bear arguments — but they are skeptical of the bullish possibilities. The market has already discounted the bearish possibilities, and it is now looking ahead.

One of the ways that bearish writers are hedging is by promising that the Dow will not better its 1051.70 high. To which I say, so what! There's no law that says that each successive bull market has to better the previous bull market peak. The 1929 high of 381 on the Dow was not bettered until 1954. But between '29 and '54 Wall Street produced two very profitable bull markets. And market breadth between 1942 and 1946 put on its biggest and most profitable upside show in history.

WAS IT A BOTTOM? I've known a few men who possessed a positively uncanny ability to see the trend of coming events, both in the US and throughout the world. But I've never known a man who could forecast how the market would react to those events.

Business continues to be rather insipid to poor. The US deficits are tremendous. The dollar has been on its back. The Arabs are cutting their currencies loose from the greenback. Congress and the President seem to be on some sort of Tower of Babel. Pessimists are still a dime a dozen, and the mails are filled with apocalyptic reports and survival bulletins. My friend, Jim McKeever, Editor of the widely-read Inflation Survival Letter, is actually moving to Canada, presumably to escape the coming American "crisis."



Despite all these depressing signs and indications, my reading of the Averages suggests that the US is not yet ready to sink, belly up, into a swirling ocean. Now that I've got all that off my chest, I'll ask you to please glance at the long-term monthly chart of the D-J Average on page 4. This is a ratio chart, showing percentages of advance or decline. (Ratio scale means that the three Averages can be compared correctly, since a rally of say 12% will show as the exact same vertical distance on each Average.)

Referring to the chart, we see (among other things) a 17-year bull market, a giant bull tide that lasted from 1949 to 1966. In some ways, this was the most controversial bull market in history. One reason for the controversy was the manner in which it ended. Note that at the February, 1966 highs, Industrials recorded a bull market peak of 995.15. Transports struck a bull peak of 271.72.

According to orthodox Dow Theory, a movement ends at the point of the last joint highs or lows. I underscore this because following the 1966 highs, Industrials rose to a new record peak of 1051.70 in 1973. Transports also recorded new record peaks in 1968 and again in 1972. But at no time did both Averages better their 1966 highs together. Therefore orthodox Dow Theory still labels 1966 as the top of the bull market that began in 1949.

During the entire period following 1966, the advance-decline ratio and most stocks trended down. But the first massive collapse in the Averages occurred during 1968 to 1970, a smash that saw Industrials at a low of 631.16, Transports at a low of 116.69. Utilities, having topped out in 1965, sank to a 1970 low of 95.86.

Following 1970 we saw a remarkable and extended bear market advance. On this rise Industrials surged to a new all-time high of 1051.70 (1973). Transports, which also rallied strongly, failed to confirm the move; they stopped just four points short of their preceding 1968 peak. To make matters even more suspect, the Transports (see chart) were actually falling away during early 1973 — even as the Industrials were recording their record highs.

The chart, as gauged by the Averages, does not show the true extent and ferocity of the crash. The fact is that a long list of stocks suffered losses of anywhere from 60% to 90%. The market was literally destroyed.

Towards the end of 1974 I changed my bearish stance, stating that I felt conditions were becoming ripe for the birth of a new primary bull market. I noted that unweighted averages were down 70% to 80%, the Dow was selling at 6 times earnings, pessimism was rampant, Wall Street was demoralized, and many analysts were openly predicting that the Dow would drop to the 350 to 500 level.

I differed with that view, and by December, 1974 I was ready to reject the bearish stance completely. I felt that at the October-December, 1974 lows, the market had probably discounted the very worst that could be seen ahead — perhaps for years to come. But one point has stuck in mind. It is a technical consideration, and one which I have glossed over previously. This technical factor is the remarkable, really "unexplainable" strength that seems to be almost built in to the Transportation Average. I can't figure it, I don't understand it — and I won't argue with it. But somebody obviously knows something that is not known to the public regarding the Transports.

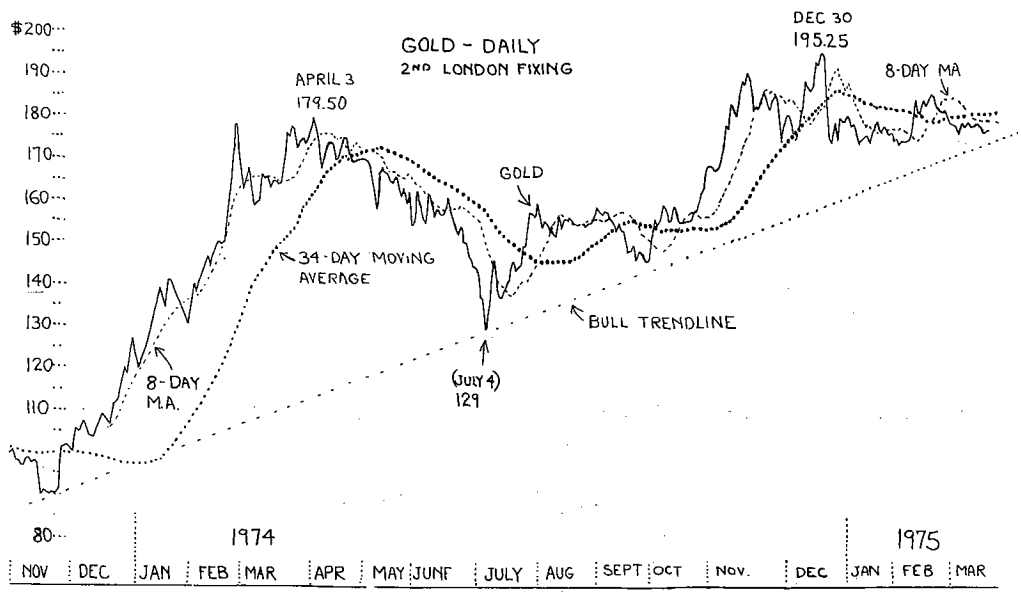
Study the monthly chart of the Averages (page 4). At the 1974 lows we witnessed a most amazing technical phenomenon. It was a kind of long and intermediate term double non-confirmation. For as the Dow collapsed to the October low of 584.56 (a twelve year low) the Transports held at 125.93, incredibly 9 points above their 116.69 low of four years earlier. The resilience of the Transports had me wondering.

Then another remarkable event occurred. The Industrials and Transports rallied strongly from their October, 1974 lows, then came down again. This time Industrials dove to a new low of 577.60 (Dec. 6). Again, Transports refused to confirm. This time Transports held at 138.31 (Dec. 16), a full 13 points above their earlier October low and 22 points above their 1970 low of 116.69! The market had to be saying something — it was shouting it loud and clear. The non-confirmations by the Transports were extraordinary.

What were the Averages saying? In my opinion, they were saying that in the face of the deep gloom, in the face of the market panic, in the face of the chaotic conditions that had people jettisoning good stocks as if they were worthless ballast, the Averages were no longer willing to plunge to new lows together. Put another way, Wall Street was saying that come what may, barring an Act of God, the worst had been discounted. The great bear market was over.

I ask myself, "Russell, suppose you're a dreamer or just a plain blockhead, suppose this is still a bear market? How would a Dow Theorist know for certain that he was wrong?" In that case, I would have to see the Industrials smash below their 1974 low of 577.60 — with Transports confirming by doing what they refused to do in December, namely, break below the 138 level and then break below the October level of 125.93. And finally, for good measure, Transports should break below their extreme 1970 bear market low of 116.69. Personally, I don't think we'll see that. I just don't believe we're going to see it!

GOLD: My momentum line for gold bullion is below 100 and still dropping (into the 90's). I stated in the last Letter that I thought gold and gold shares were in a bear market. That may have shocked a lot of people, but it's what I think. Meanwhile, the daily chart of bullion shows the drama that is unfolding. The bullion price, now below its 8-day and 34-day moving average, is testing a major trendline that has held since the 1973 low. The critical level would seem to be 170-172. Cracking that, we could see the price of gold gathering downside steam as it slides.



I also thought it was striking that in the face of the Mid-East talk breakdown, in the face of the murder of King Faisal, gold (which could be expected to explode on that kind of news) did nothing. The stocks did nothing either. Often what a stock does not do in the face of news tells you more than anything else. I think the demand for gold has now diminished sharply throughout the world. I think that the gold price has been subtly propped up by large financial interests. But I think that a primary bear trend in gold will prove stronger than any holding action, and I don't care if the supporting action comes from the French Treasury, Swiss banks or anywhere else.

But don't misunderstand my position. I'm not against the gold standard. I wish we were on it. I'm not against gold. But my job is to read markets, deal with markets, tell my subscribers what I see. I think gold and gold shares have one more major bear market leg to go on the downside, and that should almost bust the back of the gold mystique. Then, with gold in the strongest hands since the 1960's, we could see the birth of another and perhaps even bigger gold bull market.

STOCK TACTICS: One of the things that makes the stock market a very, very tough business is that although history repeats on Wall Street, each particular pattern is uniquely different. Wall Street has a way of crossing up not only the public but the great majority of experts. For instance, everyone is now used to bull markets that turn up and roar insistently to conclusion, followed by

 a bear move that looks as if it's never going to stop on the downside. My observation is that just about the time investors get used to one kind of market, that kind of market ceases to exist.

What am I driving at? Just this — I am reasonably sure that the lows for the bear market were seen during late-1974, but I am not at all sure that we are now going to have a 1960's or 1970's type whiz-bang ride to the highs. When I say that the Averages, during October-December, 1974 discounted the worst that could be seen ahead, I never promised anyone a ten-acre rose garden. I don't promise one now.

The first move of this bull market produced a magnificent 60-day buying stampede. The stampede ended on March 17, during a sharp sell-off. What do we do now? In the past two Letters I suggested holding off on further purchases. In the last Letter, I wrote that sales of up to 50% of holdings looked reasonable to me (particulary in view of the fact that the unweighted stock averages moved up a resounding 42% from the lows). At this point, I feel that any upside action is apt to look rather ragged. We are likely to see non-confirmations and a tired technical look. Therefore, I would suggest that my subscribers make a pretty substantial move to the sidelines at this time, perhaps selling two-thirds of the shares purchased earlier. Or if you want to move completely to the sidelines I see nothing wrong with that.

"If the lows were seen in 1974," you retort, "if this is a bull market, what's the point in moving to the sidelines?" My instinct tells me that this bull market is not going to be a "stairway to the stars." It's going to differ from many other bull markets that we've lived through. This bull market is much further along in the great super-cycle that started in 1932, it is going to be trickier, it may entail a need for greater precaution (to preserve profits and capital).

All right, suppose, following our move to the sidelines, the market pushes up into the 800's? In that case, the inevitable correction will probably take us back to the current level anyway. At worst, we will learn a lesson that every solvent Wall Street veteran has already learned, and that is that you don't have to be in the market all the time. The market will almost always provide at least two good buying spots during each bull year. With the Dow up 36% in three months, with the unweighted stock averages (which show a better picture of the average portfolio) up over 40%, I think it's time to move over and let some of the late arrivals carry the ball.

I have another intuition that I want to mention. I think the day of the "safe retreat" is gone. Previously, one could move out of stocks into bonds or cash or C/D's or gold shares or something and feel relatively safe. Those days are over. Now it's a matter of constant thinking and rethinking. There's no safe harbor for capital anymore, only relatively safe harbors during a given period of time. Right now I think that cash is safer than stocks, and it may be safer for a few weeks to a few months. Let's not be greedy. Most of my subscribers have garnered decent to huge profits in a period of three or four months. Let's cool it, move largely into cash and watch the show for a while. Note: at this time I think cash can be put into any of the leading liquid funds such as Dreyfus, Reserve Fund, Capital Preservation Fund. Your broker should definitely be able to arrange the transfer for you.

LATE THOUGHTS: Half my friends in this business believe we're entering a period of hyper-inflation, the other half thinks we're going into a deflationary collapse. Contrary opinion: A clash of inflationary Government deficits with the forces of deflation producing (at least for a while) the great surprise — stability. It could happen, you know.

A three-year relative strength downtrend in the Aerospace group now breaking to the upside. What does it mean? My interpretation, big defense spending to hype the economy (plus big shipments of arms to the Arabs). It also means that well-situated Aerospace stocks should outperform the market.

TECHNICAL NOTES: On the rally from the March 5 lows I said watch and see if Transports can better their March 4 peak of 168.02. They didn't, and the market stumbled. Now again I say watch 168.02. And this time we have the problem of whether the A-D will confirm on the upside if the Dow goes to a new high above the March 17 (1975 high) of 786.53. The technical picture is becoming more clouded, and the market is faced with greater technical problems than at any time in 1975. I don't say everything won't "clear up," I just say the riding is getting a bit bumpy for me.

Corrected and up-to-date:
Feb 21, DJIA 749.77; PTI 251; A-D -29.03
Feb 28, DJIA 739.05; PTI 256; A-D -29.47
Mar 7, DJIA 770.10; PTI 281; A-D -28.47
Mar 14, DJIA 773.47; PTI 280; A-D -28.13
Mar 21, DJIA 763.06; PTI 270; A-D -28.57

As this is written (Wed. Mar. 26) Industrials are up over 15 points, Transports over 3. On the decline to Mar. 25, odd-lotters ended up selling over 2 shares for every 1 purchased. Thus the public still scares easily, a big technical plus. The second very positive area is seen in the most-active stocks, which have shown tremendous strength all year. But I feel that this burst off the March 25 decline lows is bringing in quite a bit of speculation, and that the market may be getting ready for a correction. Remember, following declines, big jumps in the Dow Industrials may look dramatically bullish, but they can also set the stage for important non-confirmations. Watch 168.02 on Transports.